

Expect More Auditor Enforcement Actions From SEC In 2022

By **Chuck Smith and Andrew Fuchs** (December 22, 2021, 5:54 PM EST)

At the end of 2020, we forecasted that the incoming Biden administration would prioritize enforcement actions against auditors as gatekeepers, which would lead to a reversion to higher activity levels for such enforcement actions.

We also noted, however, that given that changes in enforcement priorities take time to implement, and given the lag from the time of those changes to the public seeing their results in disclosed settlements and resolutions, we did not expect to see evidence of increased enforcement actions until late 2021 or early 2022.

Consistent with that viewpoint, as of Dec. 21, we have not yet seen an uptick in enforcement actions against auditors. For context, the U.S. Senate did not confirm U.S. Securities and Exchange Commission Chairman Gary Gensler until April 14, and Gurbir Grewal's appointment as director of the Division of Enforcement was not effective until July 26.

As a result, regardless of an expected shift in priorities to refocus enforcement actions against auditors, 2021 had a low level of charges and settlements against auditors.

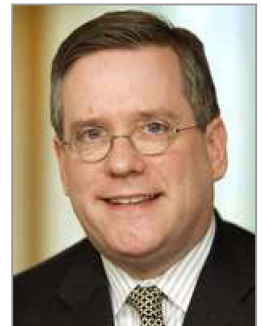
In 2021, the SEC continued its trend of bringing fewer enforcement actions against auditors than it had under the prior administration. The SEC brought just 12 enforcement actions against auditors in 2021. As a point of comparison, the SEC brought 44 such actions in 2015 but only 11 in 2020.

As to our outlook for 2022, we think it is likely that the Biden administration has already prioritized enforcement actions against auditors as gatekeepers, and thus we will see a reversion to higher activity levels for such enforcement actions. We expect to see evidence of increased enforcement actions in 2022.

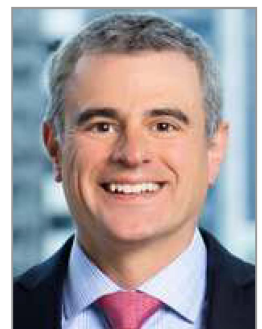
SEC Rule of Practice 102(e), which was codified in Section 602 of the Sarbanes-Oxley Act, allows the SEC to seek sanctions against an individual auditor or audit firm that has intentionally or negligently violated professional auditing or accounting standards. For such violations, the SEC typically seeks sanctions such as censures, cease-and-desist orders, fines, remedial actions, and bars from practicing before the SEC for a specific number of years, after which the auditor or firm may apply for reinstatement.

For an auditor, the implications of a practice bar go beyond the ability to audit for the duration of the bar. Under the SEC's broad view, a bar generally prohibits any work relating to the preparation of financial statements of a public company or its affiliates, which can significantly limit the scope of non-audit work an individual can undertake during a bar period.

In 2013, the SEC launched Operation Broken Gate to prioritize enforcement actions against auditors by holding accountable those auditors who intentionally or negligently violate professional auditing or accounting standards. This announcement marked the beginning of a period of increased use of Rule 102(e) to charge auditors that failed to adhere to professional standards.



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Under Operation Broken Gate, the SEC charged or settled a wide range of Rule 102(e) cases, including against auditors from prominent national firms and the firms themselves.

However, the number of Rule 102(e) charges and settlements against auditors for violations of professional auditing or accounting standards has declined in recent years as compared to the period following the announcement of Operation Broken Gate.

The statistics show that in 2021, through Dec. 21, the SEC charged or settled with 10 individual auditors under Rule 102(e), as compared with nine in 2020, 13 in 2019, nine in 2018, 18 in 2017, 29 in 2016 and 28 in 2015. Similarly, the total number of such actions, including both individual auditors and audit firms, is 12 to date in 2021, as compared to 11 in 2020, 23 in 2019, 17 in 2018, 22 in 2017, 42 in 2016 and 44 in 2015.

Despite this low number of enforcement actions, we expect the trend of diminished actions against auditors to reverse in 2022, with the total number of Rule 102(e) actions against auditors at an increased level compared to levels seen from 2017 to 2021. This expected uptick in enforcement activity would result from investigations the staff has already commenced and take its time to work their way through the system.

To that point, the Division of Enforcement's 2021 annual report contains a section titled "Ensuring Gatekeepers Live Up to Their Obligations," which focuses on enforcement actions against auditors, as well as attorneys. The renewed emphasis on auditors' roles as gatekeepers, which harkens back to Operation Broken Gate, is likely indicative of a shift in focus.

Although the 2021 sample size is small and likely not representative of future levels of activity, it is consistent with the qualitative nature of actions over the past few years. This year's activity essentially stemmed from five separate investigations.

One of those investigations, based on independence violations, resulted in charges against audit firm Ernst & Young LLP and three of its individual partners. The settlement involved a censure against the audit firm and undertakings, as well as three-year bars against the individuals. The remaining four investigations all related to audit failures of various types. When settled, these actions imposed bars of one to three years for individuals. This is in line with the nature of the sanctions we have seen over the last few years.

Further, Rule 102(e) actions against audit firms over the last few years, including one in 2021 against E&Y, reflect the SEC's continued focus on undertakings designed to prevent future independence violations. In such settlements, the SEC may require the firm to employ an independent consultant to complete a review of the firm's systems for ensuring compliance with the requirements at issue, including, for example, auditor independence requirements.

The SEC has expressed its belief that it is effectively using "undertakings that are tailored to remedial objectives and specific to the wrongful conduct at issue." In 2022 and beyond, we expect to see the SEC continue to use undertakings that require firms to engage independent consultants to assure the remediation of violations that the SEC considers to have been caused by systemic issues.

Our takeaway for SEC enforcement actions against auditors going forward is that the decreased enforcement actions against auditors in 2021 may not be representative of enforcement activity for the next few years. On the other hand, we expect that for the most part the SEC will continue to seek the same types of sanctions against individual auditors and audit firms that may have violated professional auditing or accounting standards.

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